UNITED STATES BANKRUPTCY COURT

NORTHERN DISTRICT OF CALIFORNIA

JAMES G. and DOROTHY S. HARRISON, dba PARADISE PROPERTIES, Debtors.	Case No. 91-55593-MM Chapter 7
BFR ASSOCIATES, dba DIAMOND WELL DRILLING COMPANY; ARTHUR D. FULTON, Plaintiffs, vs. J. G. HARRISON, DOROTHY HARRISON, ANNA P. K. VAN SERGAE, and DOES I-X, Defendants.	Adversary No. 92-5250 **MEMORANDUM OPINION AND ORDER THEREON**

INTRODUCTION

This proceeding concerns the estate's liability in the amount of $30,693.62 for post-petition services rendered in connection with development of a tract of unimproved property owned by the debtors. Before the Court is the plaintiffs' removed action for breach of a post-petition contract with the debtor in possession for the drilling of a water well and foreclosure of two mechanic's liens. Plaintiffs also seek to establish the estate's liability for an administrative expense claim based on the services rendered pursuant to that post-petition contract. For the reasons set forth as follows, the Court holds that the Harrisons personally and the estate are liable to Diamond. Diamond has an

allowed unsecured claim against the estate in the amount of $30,693.62, plus pre-judgment interest, attorneys' fees and costs. The reasonable amount of attorneys' fees shall be determined in a separate hearing on notice to creditors.

FACTS

The debtors, James G. Harrison and Dorothy Harrison, own a resort property in Clearlake, California, a ranch in Watsonville, California, several residential rental properties in Richmond and Berkeley, California, and approximately 400 acres of unimproved property referred to as Chualar Canyon located in Monterey County, California. The Harrisons reside in Honolulu, Hawaii. James Harrison also maintains a psychiatry practice in Honolulu. Under the name Paradise Properties, the Harrisons also own several residential rental properties in northern California, prompting them to file their chapter 11 petition on September 13, 1991 in the Northern District of California. On the same date, debtors-in-possession entered into a post-petition contract with Diamond Well Drilling Company ("Diamond") without court authority. That contract provided for the drilling of a water well on the Chualar Canyon property.

The Harrisons' daughter, Anna Van Sergae, managed their various California properties. They also appointed her as their attorney-in-fact in connection with the development of Chualar Canyon. Additionally, the Harrisons hired Richard J. Pryor, a real estate development consultant, in August 1991 to manage the construction and development of Chualar Canyon into four residential lots. The Harrisons and their agents, Van Sergae and Pryor, shall be referred to collectively as "the Harrisons" in this Memorandum Opinion. The Harrisons negotiated a contract with Diamond to drill a water well to a depth of three hundred (300) feet. Anna Van Sergae executed the contract on behalf of the Harrisons on September 13, 1991, the petition date. The contract contains a provision that any modifications to the contract must be in writing.

Diamond completed one well on October 7, 1991 to the depth of four hundred thirty (430) feet. Diamond alleges that the Harrisons orally authorized both the drilling beyond the depth set forth in the contract and the use of odex, a more expensive casing material. The first well produced water sufficient to support only one residence in the subdivision, so the Harrisons allegedly authorized

Diamond to cap the first well and to drill a second well. Diamond commenced drilling on the second well before it became aware of the Harrisons' bankruptcy petition. It learned of the bankruptcy filing on October 18, 1991. Diamond alleges that the Harrisons orally assured Diamond that it would be compensated for its labor and materials and authorized Diamond to drill to a depth of five hundred fifty (550) feet. Diamond completed the second well on October 22, 1991 with the knowledge that the Harrisons had filed a bankruptcy petition. Once again, the water flow from the second well was insufficient to support all four residences in the subdivision.

The chapter 11 trustee, Jerome Robertson, was appointed by order signed on June 5, 1992. After the trial, the trustee abandoned the Chualar Canyon property by notice and order signed on September 17, 1993. A secured creditor has also been granted relief from the automatic stay to complete a foreclosure on the Chualar Canyon property, so it is now undisputed that Diamond's claim in unsecured. The issue remains whether Diamond's claim is entitled to administrative priority.

PROCEDURAL BACKGROUND

Diamond asserts that it did not receive notice of the bankruptcy filing until October 18, 1991. Notwithstanding notice of the case, Diamond recorded two mechanic's lien against the Chualar Canyon property on November 8, 1991. The two liens total $30,693.62, the cost of the labor and materials for both wells.

On February 6, 1992, Diamond filed a complaint against James and Dorothy Harrison, Anna Van Sergae, and Does 1-X in the Superior Court for Monterey County to foreclose on the two mechanic's liens and for breach of contract for labor and materials. The debtors filed a counterclaim alleging that Diamond failed to complete and install a water-producing well and that it abandoned the well with an improper seal. Diamond also filed a motion in this court for an order directing the debtor to pay for the two wells as costs of administration. Diamond's motion was heard on April 16, 1992, at which time the parties informed the court that there was a related superior court action pending in Monterey County. The debtors stipulated to relief from stay to liquidate the claim and raised the issue of the appropriate forum for that determination. The court suggested that one option was for Diamond to remove the superior court action to the bankruptcy court, and the bankruptcy

court would consider remand and abstention, if appropriate. Diamond's motion for payment of its administrative claim was taken off the court's calendar on April 16, 1992 at the time of hearing. Diamond removed the case to this court on April 30, 1992. The defendants have not filed motions for remand or abstention.

Status conferences were held in the proceeding in August 1992 and October 1992. When the case was first called to trial in April 1993, the parties stipulated that the contract between the Harrisons and Diamond was a post-petition contract. Although the Debtors filed a joinder in the trustee's trial brief, the Debtors did not appear for the trial. Neither the trustee nor the debtors have filed motions for remand, for abstention, for summary judgment, or for dismissal for lack of jurisdiction. To date, Diamond has not filed a proof of claim, so the trustee has not filed an objection to claim.

DISCUSSION

A. The Court May Properly Exercise Jurisdiction To Hear The Case

1. The Trustee Waived Diamond's Procedural Defect In Removal

The trustee asserts that the issues raised in the removed action are not properly before this Court. The basis for this assertion is that Diamond's removal of this proceeding from the Monterey County superior court is improper because it was not timely. Bankruptcy Rule 9027(a)(3) provides that the deadline for removal to the bankruptcy court of a case that was filed post-petition is thirty days from the date of receipt of the initial pleading. Fed. R. Bankr. P. 9027(a)(3). The complaint was filed on February 6, 1992, served on March 6, 1992, and presumably received shortly thereafter because the answer was filed on March 20, 1992. The notice of removal was filed on April 30, 1992, after the hearing on Diamond's motion for an order directing the debtor to pay costs of administration. The notice of removal was not timely filed within thirty days of receipt of the complaint. Unless the removal defect is waived, the failure to file a notice of removal within thirty days of the date of receipt of the initial pleading in the state court suit would require remand to the state court. In re Exchange Parts of America, Inc., 138 B.R. 585 (Bankr. W.D. Ark. 1992).

Notwithstanding that Diamond failed to file the notice of removal timely, a procedural defect

in removal may be waived. See Gabdallah v. PG & E, 711 F.2d 988, 989 (N.D. Cal. 1989); Gray v. Moore Business Forms, Inc., 711 F. Supp. 543, 546 (N.D. Cal. 1989). Additionally, where the matter has already been heard by this Court with the consent of both parties, it would be wasteful of scarce judicial resources to decline to dispose of the relevant issues and to relegate the parties to another forum. See In re Sciortino, 114 B.R. 423, 428 (Bankr. E. D. Pa. 1990)(bankruptcy court conducted hearing on debtor's motion to vacate default judgment where plaintiff failed to file motion for remand).

Section 1447(c), Title 28 of the United States Code provides that "[a] motion to remand the case on the basis of any defect in removal procedure must be made within thirty days after the filing of the notice of removal." 28 U.S.C. § 1447(c). Section 1447(c) is applicable in the bankruptcy context to preclude an untimely motion for remand based on a procedural defect. In re Trafficwatch, 138 B.R. 841, 844 (Bankr. E.D. Tex. 1992).

Diamond filed the notice of removal on April 30, 1992. Neither the trustee nor the debtors have filed a timely motion for remand of this proceeding to the superior court in Monterey County. Moreover, a court cannot sua sponte remand a proceeding on the basis of procedural defects beyond thirty days after the filing of the notice of removal. Diaz v. McAllen State Bank, 975 F.2d 1145, 1148 (5th Cir. 1992); Federal Deposit Ins. Corp. v. Loyd, 955 F.2d 316, 323 (5th Cir. 1992). The failure timely to raise an objection to the timeliness of the notice of removal constitutes a waiver of the objection. Borne v. New Orleans Health Care, Inc., 116 B.R. 487, 490 (E.D. La. 1990). Neither the trustee nor the debtors noticed or filed a motion for remand, for summary judgment, or to dismiss the case under Fed. R. Civ. P. 12(b) on the basis that the notice of removal was not timely filed. As a result, the trustee's and the debtors' inaction constitutes a waiver of the defect in removal.

2. The Court Has Subject Matter Jurisdiction Over Claims For Breach Of Post-Petition Contracts

Even if the defect in removal had not been waived, this Court has the authority to enter a final judgment because it has original subject matter jurisdiction over the case. "'Where after removal a case is tried on the merits without objection and the federal court enters judgment, the issue in subsequent proceedings on appeal is not whether the case was properly removed, but whether the

federal district court would have had original jurisdiction of the case had it been filed in that court.'" Sorosky v. Burroughs Corp., 826 F.2d 794, 798 (9th Cir. 1987)(quoting Grubbs v. General Electric Credit Corp., 405 U.S. 699, 702 (1972)). At issue is whether the Court has subject matter jurisdiction of claims for breach of post-petition contracts. The parties have stipulated that the drilling contract is a post-petition contract. It is irrelevant to the determination whether the Court has jurisdiction over the breach of a post-petition contract that the contracting party was unaware of the bankruptcy case and the debtor's status as a debtor in possession. In re Geauga Trenching Corp., 110 B.R. 638, 645-46 (Bankr. E.D.N.Y. 1990). Based on the discussion that follows, this Court concludes that it has subject matter jurisdiction over the issues raised in this proceeding pursuant to 28 U.S.C. § 157(b)(2)(A), as well as § 157(b)(2)(B), (2)(C), and (2)(K).[1]

The Ninth Circuit has not ruled definitively whether a state law claim for breach of a post-petition contract is a core matter over which the bankruptcy courts have subject matter jurisdiction under 28 U.S.C. § 157(b). See In re Eastport Associates, 935 F.2d 1071, 1076 fn. 4 (9th Cir. 1991)(court reserved issue of claim for post-petition contract where claim at issue was pre-petition). It has, however, held that state law contract claims that do not specifically fall within the categories of core proceedings enumerated in 28 U.S.C. § 157(b)(2)(B-N) are related, non-core proceedings even if they arguably fit within the literal wording of the two catch-all provisions of (A) and (O).[2] In re Castlerock Properties, 781 F.2d 159, 162 (9th Cir. 1986). Relying on Castlerock Properties, the

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[1] 28 U.S.C. § 157(b) provides in pertinent part as follows:

(1) Bankruptcy judges may hear and determine all cases under title 11 and all core proceedings arising under title 11, or arising in a case under title 11 . . . and may enter appropriate orders and judgments, subject to review under section 158 of this title.

(2) Core proceedings include, but are not limited to -

(A) matters concerning the administration of the estate;
(B) allowance or disallowance of claims against the estate or exemptions from property of the estate, and estimation of claims or interests for the purposes of confirming a plan under chapter 11, 12, or 13 of title. . .
(C) counterclaims by the estate against persons filing claims against the estate. . .
(K) determinations of the validity, extent, or priority of liens. . .
(O) other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor or equity security holder relationship. . . .

[2] See fn. 1 supra.

Ninth Circuit in a later opinion held that post-petition state law claims against the debtor's principal shareholder for breach of contract, breach of implied covenant of good faith and fair dealing, fraud, breach of fiduciary duty, misappropriation, and unfair competition and business practice were non-core. In re Cinematronics, Inc., 916 F.2d 1444, 1450 (9th Cir. 1990). These cases appear to construe core proceedings under 28 U.S.C. § 157(b) restrictively. However, Castlerock Properties is distinguishable because the claims sought to be asserted in that case were based on the pre-petition breach of a pre-petition contract. Castlerock Properties, 781 F.2d at 160. Although the claims asserted in Cinematronics are post-petition claims, the case is distinguishable because it involved state law claims against a non-debtor. Cinematronics, 916 F.2d at 1447 fn. 2, 1450.

The Court is persuaded that a broader construction of core jurisdiction is appropriate. The Ninth Circuit indicated that Castlerock does not compel a restrictive reading of the specific subsections of § 157(b) contrary to the legislative intent to expand the bankruptcy court's jurisdiction to its constitutional limit. In re Mankin, 823 F.2d 1296, 1301 fn. 3 (9th Cir. 1987), cert. denied, 485 U.S. 1006 (1988)(state fraudulent conveyance action is core proceeding because specifically enumerated in § 157(b)(2)(H)).

In cases involving post-petition claims, the "better result is that the proceeding is core; such a [claim] 'arises in' the title 11 case, and was not owned by the debtor at the time the title 11 case was commenced." 1 Collier on Bankruptcy ¶ 3.01[2][b][iv] (15th ed. 1993). Two circuit courts have adopted this broader reading of core jurisdiction to include claims for breach of post-petition contracts. In re Ben Cooper, Inc., 896 F.2d 1394, 1399 (2d Cir. 1990), vacated, 498 U.S. 964 (1990), reinstated, 924 F.2d 36 (2d Cir. 1991), cert. denied, 111 S. Ct. 2041 (1991); In re Arnold Print Works, Inc., 815 F.2d 165, 168 (1st Cir. 1987). The Second Circuit stated:

> Logically, a post-petition contract that has as its subject matter an estate asset must be analyzed differently than one arising pre-petition.

Ben Cooper, 896 F.2d at 1399. Post-petition contracts with the debtor in possession are integral to the estate administration from the date they are entered into. Ben Cooper, 896 F.2d at 1399

(citing Arnold Print Works, 815 F.2d at 168). Actions against the debtor in possession based on post-petition contracts constitute matters concerning the administration of the estate under 28 U.S.C. § 157(b)(2)(A) "because it involves a claim that arose out of the administrative activities of the debtor in possession." Arnold Print Works, 815 F.2d at 168. The Second Circuit noted that because Castlerock dealt with a pre-petition contract, "[i]t is therefore unlikely that its holding that the proceeding in question was non-core conflicts with [this court's] holding [that post-petition contract claims are core]." Ben Cooper, 896 F.2d at 1400. This is consistent with the legislative history of 28 U.S.C. § 157, which suggests that the range of proceedings that are determined to be core should be pressed to their constitutional bounds as delineated in Northern Pipeline Construction Co. v. Marathon Pipe Line Co., 458 U.S. 50, 102 S.Ct. 2858, 73 L.Ed.2d 598 (1982). The First Circuit relied on the legislative history of section 157(b) in its ruling:

> Representative Kastenmeier said that "jurisdiction in core bankruptcy proceedings is broader than summary jurisdiction in pre-1978 law," 130 Cong. Rec. E1108 (daily ed. March 20, 1984), and [pre-1978] summary jurisdiction covered post-petition claims.

Arnold Print Works, 815 F.2d at 168. The weight of the authorities leads this Court to conclude that claims for breach of post-petition contracts are core matters over which this Court has subject matter jurisdiction.

3. The Court May Adjudicate Diamond's Administrative Expense Claim In This Proceeding

With respect to the trustee's contention that the characterization of Diamond's claim was not properly before the court, Federal Rule of Civil Procedure 15(b) authorizes the Court to amend the pleadings to conform to the evidence if the issues have been tried by implied consent. Fed. R. Civ. P. 15(b).[3] The Court also has the authority to sua sponte consolidate for a joint

[3] Fed. R. Civ. P. 15(b) provides in pertinent part:

> When issues not raised by the pleadings are tried by express or implied consent of

hearing or trial matters pending before the Court that involve common questions of law or fact in order to avoid unnecessary costs or delay. Fed. R. Civ. P. 42(a); Midwest Community Council, Inc. v. Chicago Park District, 98 F.R.D. 491, 499 (D. Ill. 1983). The purpose of consolidation is to promote convenience and judicial economy. Midwest Community Council, Inc. v. Chicago Park District, 98 F.R.D. at 499. Moreover, the trustee is bound by his Status Conference Statement filed on September 22, 1992 to the effect that the purpose of this adversary proceeding is to determine the nature and the amount of Diamond's claim.

In Yaquinto v. Greer, the plaintiff brought an adversary proceeding for conversion based on state law against the debtor and various other non-debtor defendants to recover the proceeds of a royalty check that was inadvertently paid to the debtor due to a clerical error. Yaquinto v. Greer, 81 B.R. 870, 873-74 (N.D. Tex. 1988). The bankruptcy judge recast the proceeding as a turnover action by the trustee against the non-debtor defendants. Id. at 874. The proceeding was subsequently tried absent objection to the procedure. Id. The bankruptcy court held the individual defendants liable for turnover and sanctioned them for misappropriation of debtor in possession funds. Id. On appeal, the district court held that the matter had been tried by consent under Fed. R. Civ. P. 15(b). Id. at 875-76.

> Once isses are presented and argued without objection by opposing counsel, such issues are tried by consent of the parties and are treated as if they had been raised in the pleadings.

Id. at 876. The parties had been plainly informed of the nature of the action, and the failure to object constitutes trial by consent of the issues as restated by the bankruptcy court. Id. The district court further held that the defendants had waived the argument that notice of the nature of the proceedings had been inadequate. Id. at 876-77.

> the parties, they shall be treated in all respects as if they had been raised in the pleadings.

It is undisputed that the Court has jurisdiction to adjudicate Diamond's claim. 28 U.S.C. § 157(b)(2)(B).[4] The Court may sua sponte consolidate the hearing on Diamond's claim with this adversary proceeding for breach of contract. Fed. R. Civ. P. 42(a). The trustee has been aware throughout the case that Diamond is asserting an administrative claim and seeking to liquidate that claim. The trustee's counsel has been present at the status conferences for this proceeding. No matter the procedure by which the issues were brought before the Court for hearing, the parties have been aware that the issues remain the estate's liability for Diamond's contractual claim, the characterization of the claim, and the amount of the claim. Judicial economy dictates that Diamond's claim be adjudicated in this proceeding. The case has now been tried on the merits. Although the trustee raised the issue of the Court's ability to determine the character of Diamond's claim in this proceeding in the trustee's initial trial brief, the trustee nonetheless briefed, introduced evidence regarding, and argued the issue at trial. The Court concludes that it has subject matter jurisdiction over the issues raised in this proceeding and that the issue of characterization of Diamond's claim has been tried by consent pursuant to Fed. R. Civ. P. 15(b).

B. Unauthorized Post-Petition Contracts Require Notice, Hearing, And Court Approval To Be Enforceable

1. Diamond Did Not Violate The Automatic Stay

The trustee asserts that the recordation of the mechanic's liens and the filing of the action in Monterey County were in violation of the stay and are therefore void. See In re Schwartz, 954 F.2d 569, 571 (9th Cir. 1992). However, there are authorities that suggest that the automatic stay is not applicable to bar the institution of an action against the debtor based on claims that arose post-petition. In re White, 133 B.R. 206, 209 (Bankr. S.D. Ind. 1990); In re Vacuum Cleaner Corp. of America, 58 B.R. 101, 102 (Bankr. E.D. Pa. 1986). The parties have stipulated that the drilling contract is a post-petition contract, so the claims arising from an alleged breach of the contract are post-petition claims.

[4] See fn. 1 supra.

To the extent that Diamond's actions were subject to the automatic stay, debtors' counsel stipulated on the record at the April 16, 1992 hearing to relief from the stay for the limited purpose of liquidating Diamond's claim. The trustee asserts that the stipulation is not effective because it was not properly noticed to creditors pursuant to B.R. 4001(d). However, the Court may waive the notice requirement for good cause. In re Patel, 43 B.R. 500, 503 (N.D. Ill. 1984)(court waived notice of compromise of fraudulent conveyance action to hold hearing before expiration of a redemption period, at which time asset would no longer be part of estate). The Court also has the general authority to regulate the form and manner of notices under B.R. 9007. Waiver of the notice requirements under B.R. 4001(d) is appropriate in this case because cause existed to modify the stay to allow Diamond to liquidate its claim, and the trustee is not prejudiced by a determination in this Court. The stipulation was made on the record at a properly noticed hearing on Diamond's motion for payment of an administrative claim, and the Court accepted the stipulation. The Court concludes that Diamond's actions taken post-petition were not in violation the automatic stay.

2. Courts Apply The Horizonal And Vertical Dimension Tests To Determine Enforceability Of Post-Petition Transactions

The Ninth Circuit discussed the enforceability of the debtor's post-petition transactions in In re Dant & Russell, Inc.:

> "[Th]e trustee [or debtor-in-possession], after notice and hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate." 11 U.S.C. § 363(b)(1982 & Supp. IV 1987)(emphasis added). . . . "[T]he trustee [or debtor in possession] may enter into transactions, including the sale or lease of property of the estate, in the ordinary course of business, without notice or a hearing, and may use property of the estate in the ordinary course of business without notice or a hearing." 11 U.S.C. § 363(c)(1)(1982 & Supp. IV 1987)(emphasis added). Reading subsections (b) and (c)(1)

> together indicates that the general rule is that unauthorized . . . transactions are permissible only to the extent that they are executed in the debtor's "ordinary course of business." See Waterfront, 56 B.R. at 34.

In re Dant & Russell, Inc., 853 F.2d 700, 704 (9th Cir. 1988)(footnote omitted). If a transaction is not entered into in the ordinary course of the debtor's business, the debtor must acquire court authorization after notice and a hearing for that agreement to be effective. In re Baker, 118 B.R. 24, 28 (Bankr. S.D.N.Y. 1990); In re Century Brass Products, Inc., 107 B.R. 8, 11 (Bankr. D. Conn. 1989).

Section 363 allows a debtor in possession the flexibility to engage in ordinary transactions without unnecessary creditor and bankruptcy court oversight, while protecting creditors by giving them an opportunity to be heard when transactions are not ordinary. In re Roth American, Inc., 975 F.2d 949, 952 (3d Cir. 1992). To determine whether a transaction constitutes the debtor's ordinary course of business and thus may be enforceable without a noticed hearing or court approval, courts have utilized both the horizontal dimension test and the vertical dimension test. Dant & Russell, 853 F.2d at 704. See also In re Roth American, Inc., 975 F.2d 949; In re James A. Phillips, Inc., 29 B.R. 391 (S.D.N.Y. 1983); In re Johns-Manville Corp., 60 B.R. 612 (Bankr. S.D.N.Y. 1986), rev'd on other grounds, 801 F.2d 60 (2d Cir. 1986); In re Waterfront Companies, 56 B.R. 31 (Bankr. D. Minn. 1985).

The horizontal dimension test involves an industry perspective in which the debtor's business is compared to similar businesses. Id. at 704. The inquiry of the horizontal dimension test is whether other businesses similar to the debtor's would engage in the subject post-petition transaction in the normal conduct of its business. Id. In application of the horizontal dimension test, a transaction is considered ordinary in the course of the business of the debtor in possession if it can be shown that the transaction is the type that would normally occur in the day-to-day operations of the debtor's business. Id. For example, "raising a crop would not be in the ordinary course of business for a widget manufacturer. . . ." Waterfront, 56 B.R. at 35. As further clarification of ordinariness, the Johns-Manville Court stated:

> The transaction need not have been common; it need only be ordinary.
>
> A transaction can be ordinary and still only occur occasionally.

Johns-Manville, 60 B.R. at 618 (quoting In re Economy Milling Co., Inc., 37 B.R. 914, 922 (D.S.C. 1983)).

The vertical dimension test, also known as the creditor expectation test, involves the perspective of a hypothetical creditor engaged in business with the debtor. Dant & Russell, 853 F.2d at 705. The inquiry of the vertical dimension test is "whether the transaction subjects a creditor to economic risks of a nature different from those he accepted when he decided to extend credit." Id. (quoting Johns-Manville, 60 B.R. at 616). In application of the vertical dimension test, the relevant issues for the Court to examine include the size and nature of the transaction, as well as a comparison of the debtor in possession's post-petition business transactions with its pre-petition transactions. Dant & Russell, 853 F.2d at 705. For example, accelerating the time for regular payments may render an activity extraordinary. James A. Phillips, 29 B.R. at 394-95. The Ninth Circuit noted the key to this test:

> The touchstone of "ordinariness" is . . . the interested parties' reasonable expectations of what transactions the debtor is likely to enter in the course of its business. So long as the transactions conducted are consistent with these expectations, creditors have no right to notice and a hearing . . . .

Dant & Russell, 853 F.2d at 705 (quoting James A. Phillips, 29 B.R. at 394).

3. The Post-Petition Contract Was Within The Debtors' Ordinary Course Of Business

In this case, the enforceability of the drilling contract is determined by whether it was entered into within the debtors' ordinary course of business. If not, then notice to creditors, a hearing, and court approval were required for the contract to be enforceable. Only if the contract is enforceable would the Court then have to determine the extent to which the estate is liable for its breach. See

Roth American, 975 F.2d at 952.

Applying the horizontal dimension test to the facts of this case, the Court must initially examine the nature of the debtors' business to determine the ordinariness of the disputed contract. Although the debtor maintains a psychiatry practice in Honolulu, the debtors' schedules also make it abundantly clear that the debtors are also engaged generally in the business of residential real estate investment in Northern California; hence, the filing in this district. This business includes activities such as management and leasing, as well as development. It is evident from the debtors' schedules that their various real estate holdings are likely to play a significant role in the debtors' proposed reorganization. Also significant to the Court's determination is that the debtors operate their California business under the name "Paradise Properties."

The primary focus of the horizontal dimension test is external; it involves a comparison of the debtors' business to other like businesses. Johns-Manville, 60 B.R. at 618. Similar businesses engaged in residential real estate development would be expected to contract for essential water services as well as other utility services. That the debtor may rarely contract for such services is not dispositive. As the Johns-Manville court indicated, a transaction need not occur frequently for it to be considered ordinary. Id. at 618. The drilling contract is one that a residential real estate developer might normally enter into in the ordinary course of real estate development. The facts suggest that the horizontal dimension test has been satisfied.

In applying the vertical dimension test, the Court must examine the debtors' business practices from the prespective of a hypothetical creditor. The primary focus of the vertical dimension test is the debtors' internal operations. Johns-Manville, Id. at 617. This involves a comparison of the debtors' business practices pre-petition to the course of conduct post-petition. Id. Although many of the debtors' creditors are consumer creditors, the numerous real estate investment assets that are listed on the debtors' Schedule A - Real Property should alert creditors. Creditors engaged in business with the debtors should reasonably expect the debtors to be exposed to liabilities associated with those scheduled real property assets.

An examination of the debtors' schedules also indicates that the debtors were engaged pre-petition in the business of real estate development. Among its creditors scheduled on their List of

Creditors are Archaeological Consulting, Dougherty Pump & Drilling, H.D. Peters Engineering Co., Inc., Roy Alsop Pump & Drilling, Salinas Pump Company, and Soil Surveys, Inc. for various services provided to the debtors. It is very significant to the Court's determination whether the contract with Diamond was in the ordinary course of the debtors' business that the debtors were engaged pre-petition in development activities and retained the services of surveying, engineering and other drilling businesses. The facts suggest that the vertical dimension test has also been satisfied.

Because both the horizontal dimension test and the vertical dimension test have been satisfied, the Court concludes that the transaction was within the debtors' ordinary course of business as a real estate investor. See Dant & Russell, 853 F.2d 700 (renewal of lease for wood treatment facility by operator is ordinary); In re Foundation Group Systems, Inc., 141 B.R. 196, 199-200 (Bankr. E.D. Cal. 1992)(finder's fee agreement is ordinary in computer services and counseling business). Compare Roth American, 975 F.2d 949 (extension of collective bargaining agreement which contains provision that binds debtor to maintain operations is extraordinary); Waterfront, 56 B.R. 31 (indemnity agreement requiring shareholder approval is extraordinary). As such, notice to creditors, a hearing, and prior court approval were not necessary for the contract with Diamond to be an enforceable post-petition transaction.

C. Diamond Is Not Entitled To Administrative Priority Because There Was No Benefit To The Estate

However, the mere fact the debtor breached an agreement post-petition does not automatically entitle the creditor to an administrative priority. In re Chateaugay Corp., 156 B.R. 391, 399 (S.D.N.Y. 1993), aff'd, 10 F.3d 944 (2d Cir. 1993); In re Dakota Industries, Inc., 31 B.R. 23, 26 (Bankr. D.S.D. 1983). Section 507(a)(1) provides that first priority is granted to administrative expenses allowed under section 503(b). 11 U.S.C. § 507(a)(1). Section 503(b)(1)(A) provides that administrative expenses include the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case. 11 U.S.C. § 503(b)(1)(A). A claim for administrative expenses and costs must be the "actual and necessary costs of preserving the estate for the benefit of its creditors." Dant & Russell, 853 F.2d

at 706 (citing In re Baldwin-United Corp., 43 B.R. 443, 451 (S.D. Ohio 1984)). It is insufficient merely to show that the debtor exercised business judgment in order to support a claim for administrative expense priority. In re Patch Graphics, 58 B.R. 743, 745-46 (Bankr. W.D. Wis. 1986).

Although the Court has broad discretion to award administrative priority status, the scope of expenses that are granted administrative priority status is construed restrictively in order to minimize the administrative costs to the estate. Dant & Russell, 853 F.2d at 706. The policy underlying the administrative expense priority is that the estate as a whole is benefitted if general unsecured creditors subordinate their pre-petition claims in order to secure goods and services necessary to an orderly and economical administration of the estate after the petition is filed. In re Christian Life Center, 821 F.2d 1370, 1373 (9th Cir. 1987). In awarding administrative expenses, the Court's objective is to maintain the estate in as healthy a state as possible for the benefit of creditors and to allow the essential costs of administering an ongoing business to be paid first in order to maximize the debtor's chances of emerging as a vital concern. Dant & Russell, 853 F.2d at 707. The factors that are determinative of whether a claim is entitled to administrative expense status are 1) the claim must arise from a debt incurred post-petition; 2) the claim must arise in connection with a transaction between the claimant and the debtor in possession, and 3) the claim must represent a debt incurred to benefit the operation of the debtor's business. In re Keegan Utility Contractors, Inc., 70 B.R. 87, 89 (Bankr. W.D.N.Y. 1987).

Not all post-petition debts incurred by the debtor in the ordinary course of business are entitled to administrative expense status. Dakota Industries, 31 B.R. at 26. In addition to being in the ordinary course, they must be beneficial to the estate. Id. If the Court determines that the expenditure did not benefit the estate, the Court may treat the claim like an unsecured, pre-petition claim. Id. Expenses sought as an administrative claim must have resulted in a substantial contribution to the case, which requires a tangible and demonstrable benefit to the estate and to unsecured creditors. In re Patch Graphics, 58 B.R. at 746. An actual benefit must accrue to the estate. Dant & Russell, 853 F.2d at 706. An incidental benefit to the estate is not a sufficient basis to grant administrative priority. In re D.W.G.K. Restaurants, Inc., 84 B.R. 684, 689 (Bankr. S.D. Cal. 1987);

Patch Graphics, 58 B.R. at 746; Kinnan & Kinnan Partnership v. Agristor Leasing, 116 B.R. 162, 166 (D. Neb. 1990)(mere potential of benefit is insufficient). E.g., NL Industries v. GHR Energy Corp., 940 F.2d 957 (5th Cir. 1991), cert. denied, 112 S. Ct. 873 (1991)(punitive damages for fraud in well designs); In re Selectors, Inc., 85 B.R. 843 (Bankr. 9th Cir. 1987)(severance bonus under parachute clause); In re Grant Broadcasting of Philadelphia, Inc., 71 B.R. 891 (Bankr. E.D. Pa. 1987)(unused programming under license with supplier). Compare Foundation Group, 141 B.R. 196 (finder's fee); Sav-A-Stop, Inc., 119 B.R. 317 (Bankr. M.D. Fla. 1990)(advertising costs for debtor grocery store); In re Lenz, 90 B.R. 458 (Bankr. D. Colo. 1988)(homeowner's association fees).

In this case, it cannot be maintained that Diamond's services produced an actual benefit to the bankruptcy estate in terms of development of the Chualar Canyon property into a residential subdivision. Neither well generated sufficient water flow to support four residences. The development was never completed, and Diamond's expenditures did not contribute to the debtors' business operations or to their reorganization efforts. That the trustee attempted to market the Chualar Canyon property without the development and subsequently abandoned the property is indicative of the absence of benefit to the estate from Daimond's services. In view of the policy underlying administrative expense priority, the Court declines to grant such status to Daimond's claim. Because Diamond's services did not provide a demonstrable benefit to the estate, Diamond is not entitled to administrative priority. As a result, Diamond shall be allowed an unsecured claim against the estate.

D. Personal Liability Of The Harrisons

Although the Harrisons were served with and answered the complaint, they did not appear at the time of trial. Debtors' counsel filed a joinder in the trustee's trial brief. Anna Van Sergae, the Harrisons' daughter, appeared to testify when the case first convened for trial in April 1993. At that time, the Court made clear that counsel for the trustee was not also representing the interests of the debtors at trial. The Court may enter a default judgment against defendants who fail to appear at trial. See Brock v. Unique Racketball & Health Clubs, Inc., 786 F.2d 61, 64-65 (2d Cir. 1986). Accordingly, judgment shall be entered against the Harrisons, holding them personally liable in

damages for breach of the post-petition drilling contract with Diamond.

E. Determination Of The Amount Of Diamond's Claim Is Made Under California Contract Law

The debtors breached the drilling contract with respect to the first well. The scope of that breach and the amount of damages are determined by reference to California contract law. The issue arises whether the parties may orally modify the contract as Diamond asserts they may. If the Court finds that these were valid oral modifications to the original drilling contract, then the debtors and the estate may be liable for the costs associated with the odex casing, the additional one hundred thirty feet of the the first well, and the entire second well.

Under California law, any contract provision may be waived by conduct. Bettelheim v. Hagstrom Food Stores, 113 Cal. App. 2d 873, 878 (1952)(although lease provided that waiver must be in writing, landlord waived penalty for holding over by accepting customary rent without objecting). Notwithstanding the contract clause which provides that any modifications must be in writing, the debtors may waive the provision by conduct. California law also provides that a written contract may be modified by an oral agreement. Cal. Civ. Code § 1698.[5] Under § 1698(d), a written contract may be orally modified by the common law principles of waiver and estoppel.

Arthur Fulton, the principal of Diamond, testified credibly that the Harrisons, either personally or through their representatives, authorized Diamond to drill to the depth of four hundred thirty feet on the first well and, when the first well failed to produce sufficient water flow, to drill a second well to a depth of five hundred fifty feet. Fulton also testified that the Harrisons authorized the use of

[5] Cal. Civ. Code § 1698 provides in pertinent part:

> (a) A contract in writing may be modified by a contract in writing.
> (b) A contract in writing may be modified by an oral agreement to the extent that the oral agreement is executed by the parties.
> (c) Unless the contract otherwise expressly provides, a contract in writing may be modified by an oral agreement supported by new consdieration. . . .
> (d) Nothing in this section precludes in an appropriate case the application of rules of law concerning estoppel, oral novation and substitution of a new agreement, rescission of a written contract by an oral agreement, waiver of a provision of a written contract, or oral independent collateral contracts.

odex casing on the wells. He further testified that the modifications to the written contract were made based on the Harrisons' representations that Diamond would be compensated for their services, including the services performed after Diamond became aware of the debtors' petition.

Based on the evidence introduced at trial, the Court concludes that the parties orally modified the terms of the written contract to authorize Diamond to drill to the depths specified. Because the Harrisons induced Diamond to provide the additional services with representations that it would be paid, and because Diamond relied on those representations, the debtors are estopped from asserting that the oral modifications are unenforceable. See Wagner v. Glendale Adventist Medical Center, 216 Cal. App. 3d 1379, 1388 (1989). The doctrine of waiver also applies in this case, and the Harrisons' conduct constitued a waiver of the provision in the contract that required modifications to be in writing. See Bardeen v. Commander Oil Co., 40 Cal. App. 2d 341, 347 (1940). Diamond is entitled to damages against the estate and the Harrisons for breach of contract in the total amount of $30,693.62 as pled, plus pre-judgment interest at the legal rate of ten percent (10%). Cal. Civ. Code §§ 3287, 3289.

Finally, Diamond also asserts that it is entitled to attorneys' fees and costs associated with enforcing the contract. Cal. Civ. Code § 1717 provides that the prevailing party in an action on a contract shall be entitled to attorneys' fees and costs if the contract specifically so provides. The subject contract between Diamond and the Harrisons provides in paragraph 10 of the General Conditions that the prevailing party in a contract action shall be entitled to an award of attorneys' fees and costs. The total amount of Diamond's unsecured claim shall include its costs and attorneys' fees. The reasonable amount of attorneys' fees shall be determined in a subsequent hearing.

CONCLUSION

For the reasons set forth in this Memorandum Opinion, Diamond shall be allowed an unsecured claim against the estate in the amount of $30,693.62, plus pre-judgment interest, attorneys' fees and costs. The reasonable amount of attorneys' fees shall be determined in a separate hearing on notice to creditors by Diamond. A judgment shall also be issued against the Harrisons holding them personally liable for damages for breach of the contract with Diamond. The plaintiffs shall

submit proper forms of judgments against the estate and the Harrisons.

Good cause appearing, IT IS SO ORDERED.